No. 713

IN THE

UNITED STATES

CIRCUIT COURT OF APPEALS

FOR THE NINTH CIRCUIT

F. W. COLER, *Appellant,*

vs.

HENRY F. ALLEN, PACIFIC NORTHWEST PACKING COMPANY, a corporation; THE PACIFIC NORTHWEST PACKING COMPANY, a corporation; AUSTIN CLAIBORNE, W. M. WILLIAMS and W. A. KEENE, and JOHN H. McGRAW as Receiver.

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APPEAL FROM THE CIRCUIT COURT FOR THE DISTRICT OF WASHINGTON.

BRIEF OF APPELLANT

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SPECIFICATION OF ERROR.

I.

The lower court erred in sustaining complainant's demurrer to intervenor's complaint in intervention and in dismissing that complaint upon intervenor's electing to stand thereon after demurrer sustained.

STATEMENT.

Appellant is a judgment creditor of the respondent, The Pacific Northwest Packing Company, upon whose property respondent Allen is foreclosing a mortgage. He had applied for and been granted leave to intervene in the foreclosure, had filed his complaint in intervention in pursuance of the leave given, and had been met with a demurrer by the complainant. The demurrer being sustained by the lower court, the intervenor refused to plead further, elected to stand on his complaint, suffered judgment in consequence, and appealed to this court.

The allegations of the intervenor may briefly be summed up: Coler derived his claim from The Seattle National Bank, which is alleged to have become a creditor of the packing company February 17, 1900, before the later and larger of its two mortgages sought to be foreclosed was executed. His claim passed into judgment in the State Court while the foreclosure was proceeding. At that time the properties of the foreclosure defendants were in the hands of a receiver in the foreclosure action, and it was alleged that any attempt to satisfy the judgment by execution would be idle and nugatory. It was also complained that the defendant, The Pacific Northwest Packing Company, which had given the mortgage complained of, had at the time of doing so "reached a point were its debts were greater than its property, where it could not pay in the ordinary course, where its business was no longer profitable, and

when it ought to be wound up and its assets distributed", that the mortgage was void under the laws and decisions of the State of Washington as a preference to creditors by an insolvent corporation. Complainant's bill itself has by this court been held to indicate corporate insolvency at the date on which it was filed. "We think it may be inferred from the allegations of the bill that the defendant corporation was at that time insolvent." (*Allen v. Pacific Northwest Packing Co.*, — *Fed.* —.)

It will be noticed that three points, which sometimes arise in these cases, are happily removed from discussion here. First, this is not a case of refusal to allow intervention. That had already been permitted by express order, and the ruling against Coler was that in his attempt to set aside the mortgage or have a share of it, he had not stated a cause of action. Second, he is not a subsequent creditor of the defendant corporation, whose preference he complains of, but, proceeding on an indebtedness antedating the mortgage, is a prior creditor complaining of a debtor's subsequent conveyance. Third, the claim on which he proceeds is in judgment and it is not as a mere contract creditor that he has intervened.

ARGUMENT.

The policy of the State of Washington in respect to insolvent corporations has been settled during several years (and most firmly settled), that when they have

reached such a point as is described in the complaint in intervention they can give no preference. This was first decided in the case of *Thompson v. Huron Lumber Company*, 4 Wash., 600. The court there used the exact language embodied in the present complaint in intervention, and already quoted in this brief, nor from the date of that decision to the present time has it ever varied in these rulings.

Conover v. Hull, 10 Wash. 673.
Biddle Purchasing Co. v. Port Townsend Steel and Wire Co., 16 Wash. 681.

A few preferences have escaped the rule, but only by being distinguished from it on the facts. The last utterance of the Supreme Court of the State well illustrates this.

Strohl v. Seattle National Bank, 64 Pacific, 916.

There, to be sure, the corporate preference was sustained, because a state of facts was shown that did not bring the corporation within the condition described in the Huron case, for it appeared that the corporation was doing a good business and had assets greater than its liabilities; but even there the court reiterated that rule and its repeated decisions sustaining it, quoting again the language used in the *Huron* case, and exactly repeated in the intervenor's complaint as the condition of this corporation. That language, we may add, is more unfavorable to preferences than we have used in following it. If the corporate debts are even *equal* to the assets the conveyance is forbidden, if, as alleged,

the business be unprofitable and the company no longer pays in the ordinary course.

Nor is this state of law in Washington a peculiar and unreasonable exception to the policy of other states. It is not the course of decision and the policy of a remote and too radical community, but is firmly imbedded in the jurisprudence of nearly one-half the States of the Union.

Thompson on Corporations, Sec. 6492.
27 Amer. L. Rev. 846.

Now, the Supreme Court of the United States has decided that the decisions of a State Supreme Court on this identical question of corporate preference are binding upon the federal courts, and has followed the Supreme Court of the State of Ohio.

George T. Smith Middlings Purifier Company v. McGroarty, 136 U. S. 237.

It discusses the rule as in that state established by *Rouse v. Bank* (46 Ohio St. 493, 22 N. E. 293), and says:

"That decision, it is true, proceeded in part upon a theory that the property of an insolvent incorporation is a trust fund for its creditors in a wider and more general sense than could be maintained upon general principles of equity jurisprudence. But it also proceeded in large part, as the opinion clearly shows, upon the constitution of Ohio, and the laws and policy of that state, as declared in previous decisions of its highest court, and should therefore be accepted by this court as decisive of the law of Ohio upon the subject. *It would*

be an extraordinary result, if the courts of the United States, in exercising the jurisdiction conferred upon them with a view to secure the rights of citizens in different states, should hold such a conveyance to be valid against citizens of other states as the Supreme Court of Ohio holds void as against its own citizens."

This citation would seem to us to be conclusive of the present question. The courts of the State of Washington have decided that corporations in exactly the condition described in the complaint can give no preference. The leading case in this state *(Thompson v. Huron Lumber Company, supra)* describing the condition which shall place a preference beyond corporate power used exactly the language used by the intervenor here. That language was there held sufficient, and ever since has been held sufficient, in the State of Washington. It was a case, too, of mortgage foreclosure (like this) attacked by intervening creditors, of whom some had their claims in judgment. Nay, more, our supreme court also refers to the *Rouse* case in Ohio, adopts its reasoning, and finally notes the close resemblance between the Ohio statutes and our own. (See pages 605 and 610 of the *Huron* case). It thus follows the very Ohio case by which the United States Supreme Court admits itself to be controlled.

We should be at a loss, therefore, to understand the position of the lower court in this instance were it not for the fact that Judge Hanford has indicated that *Sanford Fork and Tool Company v. Howe*, 157 U. S. 312, on the same subject, furnishes a ruling which he ought to follow. In that case the Supreme Court refused to

declare void a preference by an insolvent corporation. Whether that corporation was in as bad straits as the one involved here, or the one involved in the Ohio instance, it is profitless to consider. The Supreme Court was not called upon to consider any rule of local law in Indiana from which the case was appealed. So far as we are concerned, then, the other side may cheerfully take the position that the Sanford Fork and Tool Company was in a worse condition than the Packing Company here. It is very doubtful if it was, but for that we do not care. The preference by the Fork and Tool Company did not have to be tested by any state decision. The Supreme Court was left free to do as it pleased about it. Its decision represents only its own views on that phase of the law. Had the decision been a repudiation of decisions in Indiana, or a refusal to follow any such course of decision, it would have been in point here. It will be noticed that the Supreme Court did not find it necessary even to refer to the decision in the case of the Purifier Company. There was no reason why it should. There is no connection between the cases and one does not overrule or limit the other.

The view suggested by the lower court here, as we remember it, was that the Supreme Court followed the Ohio court, because the corporation which gave the preference there had ceased to do business and was not a going concern at all; that in the later case of the Fork and Tool Company the Supreme Court sustained the corporate preference because the corporation, though

perhaps insolvent, was still a going concern. This means that the Supreme Court will follow these State decisions where the corporation has been obliged to cease operation, but will not follow them as to corporations insolvent but still going. Now, such a test, we may respectfully say, seems to us to overlook entirely the true grounds of the decision in the first instance. The preference by the Ohio company was declared void because the courts of the State of Ohio would have held it so. The degree of corporate insolvency was not considered. Such consideration would have involved the reasonableness of the Ohio rule of property, and that was not proper inquiry for federal courts. Those courts, as the decision said, must enunciate the same rule for the citizens of other states concerning property in Ohio as the citizens of that state would have to follow. In fact, the Supreme Court, in the quotation we have made above, indicate that, if left to itself, in the Ohio case, it would have laid down a perhaps different rule from that of the Ohio court, for it conceded that the latter court "was proceeding in part upon a theory that the property of an insolvent corporation is a trust fund for its creditors in a wider and more general sense than could be maintained upon general principles of equity jurisprudence". It acknowledges, however, its duty to follow the Ohio policy and gives excellent reasons for being obliged to do so.

The decision in the Fork and Tool Company's case, as contrasted with that in the case of the Purifier Company, represents a phase of federal decision thoroughly

understood. In *White v. Cotzhausen*, 129 U. S. 329, the Supreme Court of the United States felt itself bound by the course of decisions in Illinois, where a string of simultaneous conveyances would be regarded as an assignment under the local law and not as so many transfers or conveyances. But when the Supreme Court had before it *Union Bank v. Kansas City Bank*, 136 U. S. 223, a case arising in Missouri, it held that a sweeping mortgage was not an assignment because the Missouri courts had so decided, and it had to overrule and possibly in a mild degree reprove the action of the lower federal judges, who, notwithstanding those state decisions, had continued to apply a different rule. The Supreme Court distinguished the *Cotzhausen* case just cited and showed that it had no application because decided under the rules of another state. Still later we have them in *May v. Tenney*, 148 U. S. 60, following the Colorado rule without feeling themselves in the least degree inconsistent as to the cases already cited.

In the law of chattel mortgages, too, we find the same variation, a variation without inconsistency, on the part of the Supreme Court. *Robinson v. Elliott*, 22 Wallace, 513, and *Means v. Dowd*, 128 U. S. 273, were decisions that had founded a very common opinion in the profession as to the validity and invalidity of chattel mortgages. Later came the case of *Etheridge v. Sperry*, 139 U. S. 266, which is not consistent with those cases at all; but this last case was one in which the Supreme Court were bound by the decisions of the State of Iowa.

We feel it useless to prolong this brief. Unless such

a distinction as that suggested by the lower court can be sustained it seems to us the ruling on the demurrer here must be reversed. That distinction it seems to us impossible to apply.

It cannot be denied that if a citizen of our own state were foreclosing this mortgage, as he would have to do, in the courts of this state, it would be adjudged void, and judgment creditors like Coler would, under the *Huron Lumber Company* case, be admitted to share. Is a different rule to be applied to the property because the mortgage is foreclosed by Allen, the citizen of another state? By no means. This would cause just what the Supreme Court of the United States in the case of the Purifier Company has said would be "an extraordinary result."

Respectfully submitted,

BAUSMAN & KELLEHER,
Counsel for Appellant.